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COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

FINAL COMMITTEE ACTION RELATED TO THE RECONCILIATION REQUIREMENTS OF THE FISCAL YEAR 1988 BUDGET RESOLUTION

OCTOBER 16, 1987

Prepared for use of the Committee on Ways and Means by its staff

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THE HONORABLE DAN ROSTENKOWSKI (D., ILL.), CHAIRMAN, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES FINAL COMMITTEE ACTION RELATED TO THE RECONCILIATION REQUIREMENTS OF THE FISCAL YEAR 1988 BUDGET RESOLUTION.

The Honorable Dan Rostenkowski (D., Ill.), Chairman, Committee on Ways and Means, U.S. House of Representatives, today announced that the Committee on Ways and Means completed action on its budget reconciliation recommendations to the House Budget Committee. The Committee's reconciliation recommendations -- both spending cuts and revenues -- were officially transmitted to the Budget Committee on October 15, 1987. Prior to the August recess, the Committee approved proposals which fully satisfy the Committee's reconciliation instruction to reduce spending by $9.2 billion over the next three fiscal years in programs within the Committee's jurisdiction. For a description of these spending cuts, and debt management provisions, see press releases 16-A (July 23, 1987), 17-A (July 27, 1987), 18-A (July 29, 1987), and 19-A (July 31, 1987).

On October 15, 1987, the Committee agreed to include in its reconciliation recommendations the provisions of H.R. 1720, the Family Welfare Reform Act of 1987, as reported by the Committee on July 17, 1987. In addition, the Committee approved revenue proposals which will increase revenues by $12.0 billion in fiscal year 1988, $20.0 billion in fiscal year 1989, and $19.5 billion in fiscal year 1990, for a total of $51.5 billion over the next three fiscal years. The revenue proposals approved by the Committee include:

REVENUE PROVISIONS -- PART I

A. Provisions in President's Budget for FY 1988

1. Federal Insurance Contributions Act (FICA) Tax on Tips

Under present law, an employee is subject to the employee's share of FICA tax on cash tips up to the FICA wage base, but the employer is subject to the employer's share of the FICA tax only on a certain amount of income. The Committee agreed to include all cash tips, effective January 1, 1988, within the definition of wages for purposes of the employer's share of FICA taxes.

2. Highway Excise Tax Exemptions

Under present law, private and public bus operators and State and local governments are exempt from all, or part of, Highway Trust Fund excise taxes. The Committee agreed to repeal the present-law exemption for private bus operators (but not State and local governments), effective January 1, 1988. The revenue gain would go into the Highway Trust Fund.

3. Internal Revenue Service (IRS) User Fees

The Committee agreed to require Treasury to impose user fees on requests for rulings, determination letters, opinion letters and other similar reports.

4. Bureau of Alcohol, Tobacco, and Firearms (BATF) Fees

The Committee agreed to increase certain licensing fees and excise taxes collected by the Bureau of Alcohol, Tobacco, and Firearms, effective January 1, 1988.

a. The alcohol and firearms producer occupational taxes would be increased from $110 per year (brewers) and $500 per year (firearms), to $1,000 per year and extended to distilled spirits plants, wineries, and tobacco manufacturers. A reduced rate of $500 per year would apply to businesses having gross receipts of less than $500,000 in the preceding taxable year.

b. The present alcohol wholesale dealer and firearms dealer occupational taxes would be increased from $225 per year (liquor and wine), $123 per year (beer), and $200 per year (firearms), to $500 per year.

c. The present alcohol retail dealer occupational taxes would be increased from $54 per year (liquor and wine) and $24 per year (beer), to $250 per year and would be extended to persons presently required to acquire permits for tax-free use of alcohol. (The special $4.50 tax on limited retail dealers would be repealed.)

d. The present stamp-tax rates for persons receiving drawbacks of certain alcohol taxes would be increased from a range of $25 to $100 per year, to $500 per year.

5. Customs Service User Fees

The Committee agreed to extend and revise the Customs Service user fees enacted in 1986.

a. The present ad valorem fee of 0.22 percent, applied to all formal entries of merchandise imported for consumption, would be extended through September 30, 1990. After September 30, 1988, the fee would be reduced to a rate which would provide revenue approximating the appropriated level of Customs' commercial operations, if such a rate is lower.

b. The foreign value of item 806.30/807.00 imports presently exempt would be subject to the fee (effective January 1, 1988).

c. Other technical changes relating to Customs' operations and the administration of user fees would be made.

6. Federal Debt Collection

The Federal debt collection program, under which IRS refunds are offset by past due debts to the Federal government, would be extended for three years past its present-law expiration date of December 31, 1987, to December 31, 1990, and expanded to cover both individual and corporate debts to all Federal agencies.

B. Expiring Tax Provisions

1. Telephone Excise Tax

The Committee agreed to extend the present-law 3-percent telephone excise tax for three years, through December 31, 1990.

2. Estate and Gift Tax Rate

The Committee agreed to make permanent the current maximum tax rate of 55 percent on transfers over $3 million.

3. Federal Unemployment (FUTA) Tax

Under present law, the gross FUTA tax rate is 6.2 percent of the first $7,000 of an employee's wages, comprised of a permanent component of 6.0 percent, and a temporary component of 0.2 percent, scheduled to expire on January 1, 1988. The Committee agreed to extend the 0.2 percent temporary rate through 1990. Certain technical changes, relating to the Extended Unemployment Compensation Account and Federal Unemployment Account, would also be made.

C. ESOP Estate Tax Deductions

The Tax Reform Act of 1986 (the 1986 Act) allowed a deduction from the gross estate of a decedent of 50 percent of the proceeds from a sale of employer securities by an executor to an employee stock ownership plan (ESOP) or worker-owned cooperative. The Committee confirmed the position taken by IRS Notice 87-13 that the deduction is not available unless the decedent directly owned the securities immediately before death and the securities are allocable to participants. This confirmation applies to sales of employer securities after October 22, 1986. The maximum allowable deduction would be limited to 50 percent of the taxable estate (determined without regard to the deduction), and the maximum reduction in tax liability would be limited to $750,000. The Committee agreed to other limitations contained in H.R. 1311. Generally, these limitations would apply to sales (or in certain cases, taxable events) after February 26, 1987, the date of introduction of H.R. 1311.

D. Estimated Taxes

1. Relief for 1987

The provision of the 1986 Act increasing from 80 to 90 percent the percentage of the current year's individual liabilities, that must be paid as estimated taxes, would be delayed until 1988. For estimated tax payments due before July 1, 1987, all corporations would be permitted to base those payments on 1986 liabilities. Statutory authority would be provided for safe harbors provided in Treasury regulations.

2. Corporate Estimated Tax Reform

a. The underpayment penalty with respect to any installment would apply to the difference between payments made by the due date of the installment, and the lesser of an installment based on (1) 90 percent of the tax shown on the return; or (2) 100 percent of the tax shown on the preceding year's return. As under present law, exception (2) would generally not apply to a corporation having at least $1 million of taxable income in any of the three prior taxable years, except that such a corporation could use that exception for purposes of making its first estimated payment for any taxable year. Net operating loss and capital loss carryforwards and carrybacks would be disregarded in calculating taxable income for this purpose.

b. The full rate of the penalty would be imposed with respect to any payment only to the extent the total payments for the year, up to the required installment, are below 90 percent of the taxes which would be due if the income already received during the current year was placed on an annual basis. Any reduction in a payment resulting from using the annualization exception must be made up in the subsequent payment if the corporation does not use the annualization exception for that subsequent payment.

c. No penalty would be imposed if the tax ($40 under present law) for any taxable year is less that $500.

These provisions would be effective for taxable years beginning after 1987.

E. Provisions Affecting Individual Taxpayers

1. Child and dependent care credit

The Committee agreed that costs incurred to send a child to an overnight camp would be ineligible for the child care credit. The provision would be effective for taxable years beginning after 1987.

2. Mortgage interest deductions

The Committee agreed that the amount of debt eligible for the qualified res.dence exception to the nondeductibility of interest would be limited to $1,000,000. Interest on debt in excess of amounts to acquire or substantially improve a taxpayer's principal or second residence (home equity loans) would be limited to $100,000. This limitation replaces the 1986 Act rule with respect to educational and medical loans. In addition, boats and mobile homes used on a transient basis would be ineligible to qualify as second residences for purposes of the interest expense deduction. The provisions would be effective for taxable years beginning after 1987 with respect to indebtedness incurred after October 13, 1987.

3. Cafeteria Plans

Present law provides that an employee who has the option to receive cash in lieu of benefits under a cafeteria plan is not subject to income tax or FICA and FUTA taxes on the cash option, unless he elects to receive the cash. The Committee agreed to limit this rule to cafeteria plans permitting a cash option of $500 or less. Under the agreement, if the employee has the option to elect more than $500 in cash, the entire amount he may elect is subject to income, FICA, and FUTA taxes, whether or not he elects to receive it. The provision would be effective for taxable years beginning after 1987.

4. Definition of active participant for Individual Retirement Account (IRA) rules

The Committee agreed to modify the definition of active participants in a qualified pension plan established by the United States, by making it clear that Federal judges are active participants for purposes of the IRA deduction limit, and employees for purposes of the Code. The provision would be effective for taxable years beginning after 1987.

5. Below-Market Loans to Continuing Care Facilities

The Committee agreed to apply the below-market loan rules to loans made to continuing care facilities and other similar facilities that provide consumption items in connection with the loan. The provision would be effective for loans made after October 13, 1987.

F. Like-Kind Exchanges of Real Estate

The Committee agreed to limit the amount of gain a person could defer where there is a like-kind exchange of real estate, to $100,000 per year. The rule would apply to property used in a trade or business, or held for investment purposes, and not to principal residences. The provision would be effective for exchanges after October 12, 1987, with

an exception for exchanges, pursuant to written binding contracts to exchange property, in effect on October 12, 1987.

G. Estate and Gift Taxes

1. The Committee agreed to phase out, at a 5-percent rate, the benefit of the unified credit and tax brackets below 55 percent for transfers exceeding $5 million. The provision would be effective for transfers after 1987.

2. Effective for decedents dying after 1987, transfers of disproportionate appreciation in an enterprise, while retaining disproportionate control or income, would be included in gross estates. Effective for transfers occurring and decedents dying after 1987, property held, directly or indirectly, by an individual, or by members of such an individual's family, would be treated as held by one person for purposes of estate and gift tax valuation.

3. The credit for State estate, inheritance, legacy or succession taxes against the Federal estate tax, would be converted into a deduction. The provision would be effective for decedents dying after 1987.

H. Provisions Related to Tax Accounting

1. Completed Contract Method of Accounting

The Committee agreed to apply the percentage of completion method to the full amount of all long-term contracts (other than contracts of small businesses exempted under present law). The provision would be effective for contracts entered into after October 13, 1987. An exception would be provided for manufacturers of certain commercial ships.

2. Application of Code Section 265 to Installment Sales Obligations of State or Local Governments

The Committee agreed that firms selling items to State or local governments under an installment sales arrangement, would be disallowed a deduction for a portion of interest paid, equal to the ratio of the taxpayer's average holdings of such obligations, to its average assets. In addition, a de minimis rule would be set at the lesser of, $1 million, or 2 percent of assets, for disallowing interest on indebtedness incurred, or continued, to purchase, or carry, tax-exempt obligations by non-financial institutions. The provisions would apply with respect to tax-exempt obligations acquired after 1987.

3. Cash Method of Accounting for Farms

The Committee agreed to require the accrual rather than permit the cash method of tax accounting for any entity engaged in the trade or business of farming, with average annual gross receipts in excess of $25 million, regardless of whether the entity meets the family farm exception of present law. The provision would be effective for taxable years beginning after 1987. The adjustment required by the change in method of accounting would be credited to a suspense account. The amount in the suspense account would be taken into income in the year in which the entity first failed to meet the terms of the family farm exception or as the entity reduced in size.

4. **Market Discount Bonds**

The Committee agreed to include market discount on a bond (other than U.S. Savings Bonds) as interest income for bonds acquired after October 13, 1987. Includible amounts would be computed using a simplified method, unless the holder elects to use the economic accrual method.

5. **Amortization of Customer Base Intangibles**

The Committee agreed to clarify that no amortization or similar deduction would be allowed for intangible assets that are renewing (such as an existing customer base), or that have an indeterminate useful life. The provision would apply to acquisitions after October 13, 1987, unless pursuant to a binding written contract in effect on that date.

6. **Vacation Pay Reserve**

The Committee agreed to allow a deduction for vacation pay reserves only for amounts paid, or funded amounts which vest, during the taxable year, or within 2 1/2 months after the end of the year, for taxable years beginning after 1987.

7. **Last-in First-Out (LIFO) Recapture on Conversion from C to S Corporation**

The Committee agreed to include LIFO recapture amounts in the income of corporations that convert from C to S status after October 13, 1987.

8. **Trade Associations**

The Committee agreed to treat the investment income of organizations described in Code section 501(c)(6) (generally referred to as "trade associations") as unrelated business taxable income except to the extent set aside for charitable purposes, and except for gain on certain dispositions of assets used in performing the organization's tax-exempt purposes. The provision would apply to taxable years beginning after 1987.

I. **Partnership Provisions**

1. **Limited Partnerships**

a. The Committee agreed that publicly traded limited partnerships, that engage in active business activities (as defined for this purpose and to exclude certain real estate and natural resources activities), would be treated as corporations for Federal income tax purposes. Publicly traded partnerships would include those whose interests are traded on existing exchanges (including over the counter), and those in which a market is effectively made. The provision would be effective with respect to partnerships formed, or substantially expanded (or whose activities are substantially changed), after October 13, 1987, or that become publicly traded and engage in active business activities after that date. Partnerships which filed a registration statement with the Securities and Exchange Commission on or before October 13, 1987, are considered to be formed prior to October 13, 1987. The provision would apply to all publicly traded active limited partnerships for taxable years beginning after 1994.

b. The Committee agreed that net income of publicly traded limited partnerships, that are not otherwise treated as corporations, would be treated as portfolio income to the partners under the passive-loss rule. The provision would be effective as if enacted with the passive-loss rule of the 1986 Act, i.e., for taxable years beginning after December 31, 1986.

c. The Committee agreed that tax-exempt organizations' distributive shares of income from any publicly traded limited partnership (that is not treated as a corporation for Federal income tax purposes), would be treated as unrelated business taxable income without regard to the underlying character of the income. The provision would be effective for income from partnership interests acquired (including by contribution) after October 13, 1987.

d. The Committee agreed that collection of deficiencies, with respect to partners' tax liabilities, would be imposed at the partnership level for both publicly traded partnerships and publicly offered partnerships (including those required to file a notice under applicable securities rules). The provisions would be effective for taxable years beginning after 1987. Related measures for simplifying the administration of partnership-level audits were also agreed to.

e. The Committee agreed that the treatment of publicly traded limited partnerships (and other partnerships that significantly resemble corporations) as corporations for Federal income tax purposes, would be studied, including the issues of disincorporation and of opportunities for avoidance of the corporate tax. The study would be completed by January 1, 1989.

2. Treatment of Tax-Exempt Partners

The Committee agreed that the exemption from treatment as unrelated business income for debt-financed real property held by a partnership, including tax-exempt partners, would be available only if partnership allocations to tax-exempt organizations are consistently the same for all items, and have substantial economic effect. The provision would be effective for debt-financed property acquired after (and acquisition debt on such property incurred after) October 13, 1987, unless such property was acquired pursuant to a binding written contract in effect on that date.

J. Provisions Affecting Corporations

1. Corporate Minimum Tax

The Committee agreed that 100 percent of the excess of book income (for taxable years beginning before 1990), or adjusted current earnings (for taxable years beginning after 1989), over other alternative minimum taxable income, would be a preference item for corporate taxpayers. The provision would be effective for taxable years beginning after 1987.

2. Corporate Dispositions

The Committee agreed that liquidating dispositions to a corporate 80-percent distributee are to be taxed in the same manner as nonliquidating distributions under present law. Similar rules would apply to foreign corporations. Gain would be deferred in the case of a liquidating distribution to a parent corporation filing a

consolidated return with the distributing corporation, generally until triggered by a subsequent disposition. Certain rules for dispositions, including intragroup divisive stock distributions and the deemed dividend rules for corporations, would be modified so that the results are not more favorable than in the case of an actual dividend. The provision would be effective for distributions after October 13, 1987.

3. Debt Financing of Corporate Acquisitions

The Committee agreed generally to deny deductions for interest exceeding $5 million a year on debt directly, or indirectly, supporting either (1) the acquisition of 50 percent or more of the stock of another corporation, or (2) the redemption of 50 percent or more of the issuer's stock. The provision would be effective for acquisitions or redemptions after the date of Committee action unless pursuant to a binding written contract, board action, shareholder approval, letter of intent, tender offer, or public announcement to shareholders in effect on that date at all times thereafter. Such transactions would be grandfathered provided the acquisition or redemption is completed before January 1, 1989.

4. Corporate Takeovers

The Committee agreed to impose a 50-percent nondeductible excise tax on "greenmail" gain on stock that is held less than two years by a person who has made, or threatened, a hostile tender offer, and that is redeemed by the company. The provision would be effective with respect to payments received after date of enactment.

The acquisition after date of enactment of 80 percent, or more, of the stock of a company would be treated as if the corporation had sold all of its underlying assets in the hands of the purchaser, if any significant portion of the stock was acquired pursuant to a hostile offer.

No interest deduction would be allowed for indebtedness incurred after date of enactment to acquire stock, or assets, of a corporation, if 20 percent or more of the stock was acquired in a hostile purchase.

5. Computation of Earnings and Profits for Intercorporate Dividends and Basis Adjustments

The Committee agreed to overrule the Woods Investment Company case. Thus, in determining a parent corporation's basis in the stock of a subsidiary with which it files a consolidated return, the earnings and profits of the subsidiary would be determined without regard to the special adjustments otherwise required under the Code. Earnings and profits for this purpose would not include any cancellation of indebtedness income of the subsidiary not taken into account in computing taxable income. Outside a consolidated return context, the changes to the definition of earnings and profits enacted in 1984 would be expanded to include adjustments for accelerated depreciation. The provision would apply to dispositions after October 13, 1987, taking into account the principles of the amendment during the entire holding period of the stock.

6. Consolidated Return Pass-Through

The Committee agreed to limit consolidation of a subsidiary's income, or loss, to a percentage equal to the percentage of stock owned by members of the affiliated group. The provision would be effective for taxable years beginning after 1987.

7. Tax Loss Mergers and Acquisitions

The Committee agreed to:

(a) subject built-in depreciation to the built-in loss rules of Code section 382.

(b) reduce the loss carryforwards of a corporation in bankruptcy, by the full amount of the excess of the debt cancelled in the proceeding, over the fair market value of the stock given to creditors in exchange for debt.

(c) preclude loss corporations from using their losses to shelter built-in gains of an acquired company recognized within 5 years of the acquisition.

Items (a) and (b) would apply to ownership changes after October 13, 1987. Item (c) would apply to acquisitions after October 13, 1987. Transition relief would be provided for transactions pursuant to a binding written contract in effect on that date.

8. Dividends Received Deduction

The Committee agreed that the 80-percent dividends received deduction would be reduced to 75 percent of the amount of the dividend for dividends paid after 1987.

The Committee also agreed to disallow with respect to stock issued after October 13, 1987, the 80 percent dividends received credit on stock that has certain non-stock characteristics including non-voting preferred stock, stock that provides mechanisms to recover principal or maintain dividend levels, or stock that has certain redemption or secured interest characteristics.

9. Net-Operating-Loss (NOL) Carryforwards Following Worthless Securities Deduction by Shareholder

The Committee agreed with respect to deductions after October 13, 1987, to treat a shareholder as having sold to an unrelated person for purposes of applying the loss limitations of Code section 382 if a worthless securities deduction is claimed by the shareholder, thus limiting net operating loss carryovers of the subsidiary.

10. Personal Service Corporations

The Committee agreed to disallow the application of the graduated corporate rates to personal service corporations effective for taxable years beginning after 1987.

11. Deferral of Foreign Income for "Runaway Plants"

The Committee agreed to tax currently income from "runaway plants," U.S. corporations' foreign subsidiary plants whose output is destined for use or consumption in the United States. A separate foreign tax credit limitation would apply to such income. The provisions would be effective for taxable years beginning after 1987.

12. Income from Operations in South Africa

The Committee agreed to add South Africa to the list of countries where foreign tax credits and certain other benefits are denied with respect to income attributable to activities in those countries. The provision would apply to taxable years beginning after 1987 and would

terminate once the South African government had taken certain steps to end apartheid.

13. Full Funding of Pension Plans

The Committee agreed that a contribution to a defined benefit pension plan would not be deductible to the extent that (1) it exceeds the present-law full funding limitation, or (2) after the contribution, the plan's assets exceed 150 percent of the plan's termination liability. The provision would apply to taxable years beginning after 1987. Under the agreement, Treasury would have the authority to make modifications in the allowable percentage of termination liability in order to reflect the age profile of the employees and retirees covered under the plan.

K. Insurance Provisions

1. Mutual Life Insurance Companies

The Committee agree that for purposes of the minimum tax an adjustment would be added to the calculation of book income of mutual life insurance companies to include the differential earnings amount. The provision would be effective for taxable years beginning after 1987.

2. Foreign Insurance Companies

The Committee agreed to extend to foreign property and casualty insurance companies the rules for determining the amount of investment income that is effectively connected with the conduct of a life insurance business in the United States. In addition, the imputation rule would be strengthened to prevent foreign insurance companies from artificially decreasing the amount of investment income subject to tax in the United States. The provisions would be effective for taxable years beginning after 1987.

3. Insurance Syndicate

The Committee agreed to deny to members of a United Kingdom insurance organization three-year deferral of underwriting income or loss as provided by a closing agreement between the IRS and the members of that organization. Rules generally applicable to property and casualty insurance companies would apply to such income or loss for taxable years beginning after 1987.

4. Interest Rate Used in Computing Reserves

The Committee agreed that the interest rate used in determining reserves for life insurance and annuity contracts would be the greater of the prevailing State assumed interest rate or the applicable Federal rate (AFR). The provision would apply to life insurance and annuity contracts issued after 1987.

L. Other Provisions

1. Targeted Jobs Tax Credit

The targeted jobs tax credit would not be available to an employer for wages paid to a worker who performs the same or substantially similar services as those of employees participating in, or affected by, a strike or lockout at the employer's plant or facility. This provision would apply to amounts paid or incurred on or after January 1, 1987, for services rendered on or after such date.

2. Tax-Exempt Bonds for Indian Tribes

The Committee agreed that the authority of Indian tribes to issue tax-exempt bonds would be expressly limited to those purposes for which tax-exempt bonds generally are issued by State or local governments. The provision would apply to bonds issued after October 13, 1987.

3. Tax-Exempt Bonds to Acquire Existing Output Facilities

The Committee agreed that the use of tax-exempt bonds, directly or indirectly, to acquire the assets of, or interests in, existing output facilities, within the meaning of Code section 141(b)(4), would be subject to the private activity volume cap. The provision would be effective for bonds issued after October 13, 1987, with an exception for an acquisition pursuant to a State law.

4. Unclaimed IRS Refunds

The Committee agreed, effective on date of enactment, to require that unclaimed Federal tax refunds remain in the General Fund of the Treasury.

5. IRS Funding

The Committee agreed to a Sense of the Congress Resolution regarding IRS funding, and mandate a study of possible measures to decrease the tax gap.

6. Certain Farm Water Subsidies

The Committee agreed to include in income the value of any water subsidies that are in violation of present Federal limitations, or limitations that may be adopted in the future, on water subsidies. The provision would be effective for water delivered after 1987 to taxpayers using water for agricultural purposes.

7. Collection Point for Diesel and Special Motor Fuels Excise Taxes

The Committee agreed that the diesel fuel and special motor fuels excise taxes would be collected by wholesale dealers. The provision would be effective on January 1, 1988.

REVENUE PROVISIONS -- PART II -- TECHNICAL CORRECTIONS

The Committee agreed to include as a part of its reconciliation recommendation Technical Corrections to the Tax Reform Act of 1986. This part includes H.R. 2636 as introduced on June 10, 1987, and modified by an amendment offered by Chairman Rostenkowski. That amendment is described in the document entitled "Description of Amendments by Chairman Rostenkowski to H.R. 2636 (The Technical Corrections Act of 1987)," (JCX-14-87).

REVENUE PROVISIONS -- PART III

The Committee also agreed to additional revenue measures, including minor revisions to the Tax Reform Act of 1986. These include items described in "Summary Description of Revenue Reconciliation Provisions to be Considered by the Ways and Means Committee," (JCX-15-87), Part Three. Not all of these items are summarized in this press release.

A. Provisions Relating the Tax Reform Act of 1986

1. Individual Income Tax Provisions

a. A taxpayer would not be ineligible for the earned income tax credit merely because Aid to Families With Dependent Children (AFDC) constitutes more than half the support of the taxpayer's children.

b. The total amount of qualified tuition reduction granted to a graduate student engaged in teaching or research activities for a college or university would be excludible from income (up to the amount of the student's tuition fees), effective for taxable years beginning after December 31, 1986.

c. The two-percent floor under miscellaneous itemized deductions would not apply to indirect deductions with respect to publicly offered mutual funds, effective for taxable years beginning after December 31, 1986.

2. Capital Cost Provisions

a. Citrus trees would be assigned a recovery period of seven years.

b. Single-purpose agricultural structures that are used for raising poultry would be assigned a recovery period of eight years and all other single-purpose agricultural or horticultural structures would be assigned a recovery period of 12 years.

c. Property used in farming would be recovered using a 150-percent declining balance method.

d. If replacement property is placed in service within two years of a fire, storm, or other casualty, the amount of the Investment Tax Credit (ITC) recapture would be reduced by the amount of the ITC that would have been available with respect to the replacement property.

e. Beginning after 1987, railroads would be permitted to deduct currently expenses properly treated as repairs under general Federal income tax principles.

f. A number of liberalizing amendments to the low-income housing tax credit were agreed to.

3. Accounting Provisions

a. The uniform capitalization rules would be made inapplicable to costs incurred by freelance writers and photographers.

b. An election would be provided for entities required to change their taxable years as a result of section 806 of the Tax Reform Act of 1986 to retain their taxable years. The election would require partners in an electing partnership and shareholders in an electing S corporation to make enhanced estimated tax payments. Personal service corporations could not currently deduct all payments made after the close of the calendar year to owner-employees unless sufficient amounts had been paid prior to the close of the calendar year.

c. Installment sales by nondealers generally would not be subject to the proportionate disallowance rule. However, if the amount of installment debt arising from a sale exceeds $2.8 million or the amount of installment debt arising from all sales in a taxable year exceeds $5 million, the proportionate disallowance rule would apply. Gain on installment sales by nondealers would be recognized if the obligation was pledged. Nondealers would be allowed to use the installment method for the purpose of computing alternative minimum taxable income.

d. Common trust funds would be required to adopt a calendar year, effective for taxable years beginning after 1987.

e. Prior law rules would apply to contributions in-aid-of-construction to water companies with average gross receipts of less than $10 million.

f. The preproductive period for any cattle or horse that will have more than one yield will begin at the time of its acquisition or birth and end when the animal has its first yield. This rule will apply to active farmers only.

g. The percentage treated as payment on outstanding installment indebtedness of a dealer under the proportionate disallowance rule for a year could not be less than 60 percent of the installment obligations arising in that year. The provision is effective for installment sales made after October 15, 1987.

h. The Secretary of the Treasury would be directed to issue regulations implementing the directive of the 1986 Tax Reform Act to provide a simplified method for applying the uniform capitalization rules in the case of taxpayers that acquire property for resale. The allocation ratio for apportioning storage costs and related handling costs shall be determined by dividing the amount of such costs by beginning inventory balances and gross purchases during the year.

4. Financial Institution and Insurance Provisions

a. The percentage of income deductible as an addition to the reserve for bad debts of a thrift institution in 1987, would be adjusted so that all thrift institutions would have the same effective tax rate, regardless of whether they use a calendar or fiscal year.

b. Charitable gift annuities generally would not be treated as commercial-type insurance. IRS annuity tables would be modified.

5. Pension, Employee Benefit and ESOP Provisions

a. With respect to qualified plans maintained by public employers, distributions could be deferred until an employee retires, even if after age 70 1/2.

b. Eligibility for 401(k) plans for tax-exempt employers would be expanded.

c. The amendment would clarify that Code section 457 does not apply to nonelective deferred compensation.

d. Miscellaneous modifications of the provisions applicable to employee stock ownership plans (ESOPs) were adopted.

6. Foreign Tax Provisions

a. The effective date of the Tax Reform Act of 1984 rule regarding the disregard of the installment method of accounting in computing earnings and profits would be postponed to taxable years beginning after 1988.

b. The allocation and apportionment of expenses of U.S. R&D activities between U.S. and foreign source income would be determined by allocating 67 percent of such expenses to U.S. source income.

7. Tax-Exempt Bond Provisions

a. The definition of manufacturing facility in connection with small issue IDBs would be clarified.

b. The exemption from rebate for governmental units issuing no more than $5 million in a calendar year would be expanded to cover such governmental units issuing no more than $10 million in a calendar year.

8. Workers' Compensation Funds

In the case of workers' compensation funds, (1) the funds would be granted relief from deficiency assessments relating to the timing of policyholder dividend deductions for taxable years beginning before January 1, 1987; and (2) the changes to the taxation of property and casualty insurance companies (discounting, treatment of unearned premiums, and proration), enacted by the 1986 act would be effective for taxable years beginning after 1988.

B. Other Provisions

1. Funding for National Vaccine Injury Compensation Program

The Committee agreed to establish a new Vaccine Injury Compensation Trust Fund to administer the National Vaccine Compensation Program enacted in 1986 and amended in 1987 to provide a source of compensation for individuals who are injured or die as a result of certain childhood vaccines administered after September 30, 1988, and before October 1, 1992.

The new Trust Fund would be funded by amounts equivalent to revenues (net of income tax offsets) from an excise tax on vaccines. The new excise-tax rates would be $4.56 for DPT; $0.06 for DT; $4.44 for MMR; and $0.29 for polio vaccines, effective on January 1, 1988. No exemptions would be provided from the new excise tax.

Compensation authorized under the program for up to 3,500 injuries from vaccine administrations between July 1, 1977, and October 1, 1988, would be provided by general revenue appropriations to the Public Health Service, pursuant to legislation considered by the House Energy and Commerce Committee.

2. Enjebi Community Trust Fund

The Committee agreed to exempt the Enjebi Community Trust Fund, established to rehabilitate Enjebi Island of the Enewetak Atoll from any form of Federal, State or local taxation.

3. Rollover of Gain on the Sale of Principal Residence

The nonrecognition rule for rollover of gain on the sale of a principal residence is extended to apply where (1) one spouse dies after the date of selling the old residence but before purchasing the new residence, and (2) within the specified time period. The provision applies with respect to sales of old residences after December 31, 1984. In addition, the special nonrecognition rule that applies to military service personnel serving overseas would be extended to ambassadors and members of the Foreign Service. This provision would be effective January 1, 1987.

4. Oil Spill Liability Trust Fund and Petroleum Tax

The commencement date of the Oil Spill Liability Trust Fund and 1.3-cent-per-barrel petroleum tax would be extended so that the trust fund and tax would take effect if qualified legislation authorizing an oil spill liability program were enacted by September 1, 1988.

5. Work Incentive Jobs Credit (WIN)

Certifications for the work incentive jobs credit as in effect for taxable years beginning before 1982 must be made on or before the day the individual begins work. This provision would be effective for purpose of credits first claimed after March 11, 1987.

OTHER PROVISIONS -- PART IV

A. Family Welfare Reform

The Committee agreed to include H.R. 1720, the Family Welfare Reform Act of 1987, as reported by the Committee on Ways and Means, in the budget reconciliation package.

H.R. 1720 makes improvements in the basic Federal welfare program, Aid to Families with Dependent Children (AFDC). The Act would promote family stability, self-support through work, the payment of child support, and improvements in need-based cash support for families. A key feature of the Act is mandatory work, education, and training program for welfare recipients that is targeted to those who may be long-term dependents, coupled with support services (principally day-care and health benefits) for working single parents.

B. Aid to Families with Dependent Children (AFDC) Homeless Provisions

The Committee agreed to a provision which would prohibit the Department of Health and Human Services from issuing regulations restricting AFDC emergency assistance payments and payments for "special needs" of AFDC recipients. In addition, a demonstration program would be authorized permitting any State which provides for temporary shelter as a special need to test a homelessness prevention program for AFDC recipients.

C. National Commission on Children

The Committee agreed to establish a bipartisan Commission on Children to bring national attention to and devise national solutions for the problems of America's children and families. The Commission would be required to report its recommendations no later than September 30, 1988, and would recommend improvements in the areas of health, social and support services, education, income security and tax policy.

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